



Palestine Economic Policy Research Institute

Housing and Mortgage Loans in Palestine

**Ibrahim Abu Hantash
Obaida Salah**

2009

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- ♦ Evaluating economic and social policies and their impact at different levels for correction and review of existing policies.
- ♦ Providing a forum for free, open and democratic public debate among all stakeholders on the socio-economic policy-making process.
- ♦ Disseminating up-to-date socio-economic information and research results.
- ♦ Providing technical support and expert advice to PNA bodies, the private sector, and NGOs to enhance their engagement and participation in policy formulation.
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Foreword

Economists suffer from a type of schizophrenia when it comes to investment in residential housing. On the one hand, economic theory favours investment in housing because it helps fulfil human and social needs. It also helps reduce rent and therefore the cost of living and inflation. Furthermore, investment in housing increases employment, especially among unskilled and semi-skilled labourers, and increases demand for building materials.

On the other hand, investment in residential buildings remains an unproductive investment compared to investment in machinery, factories or other productive means that generate a continuous flow of value-added. Investment in housing is of a speculative nature due to the finite land areas in urban spaces. Rarely has a study of the Palestinian economy been made without agonising over the fact that the largest share of the total investment in Palestine goes to housing (about 50% of the total investment in 2007 and almost 70% in 1994).

To further complicate matters, owning a house has a particular socio-cultural significance in Palestine, perhaps more so than in neighbouring countries. There is a general belief that owning a house protects the family from life's worst adversities, even those particular to the Occupied Territories. Once a family has a shelter, the breadwinner need only provide the basic necessities, such as food and clothing. These basic needs can be provided relatively easily, as families can adjust their consumption inline with fluctuations in their income. In other words, owning a house in Palestine is not only a matter based on the cold economic calculations of cost and benefits.

It is made clear by the study, as well as from observation on the ground, that Palestine is in need of a large expansion of the housing sector. This is not only necessary due to natural population growth and immigration, but also important to help improve current living conditions. The expansion is particularly urgent after the softening of a number of strict restrictions imposed by the Israeli's on construction throughout the Palestinian Territory. In spite of the legitimate worry of the concentration of investment in the housing sector, and subsequent adverse economic effects, the real problem lies with sluggish investment in other productive sectors rather than excessive investment in housing.

The overall aim of this study is to analyse the state of the housing sector in Palestine. It aims to estimate demand, analyse the factors that affect this demand and, consequently, estimate the demand for mortgages. The study also aims to identify the sources of mortgage lending currently available in the Palestinian Territory, the conditions of this lending, and the problems facing the expansion of these instruments.

The study concentrates mainly on the demand for ‘affordable housing’ – that is housing units priced at no more than four times the annual income of a middle-income Palestinian family (a housing unit of \$60,000 assuming a monthly family income of 5000 NIS).

One of the important questions the study aims to answer is the following: what are the interest rates, loan periods, and share of the down payment that an average family in Palestine is likely to accept in order to buy a house valued at \$60,000? This core question leads to another question: what would constitute an optimal package which would maximise demand for mortgage loans in Palestine?

The study has been prepared by MAS in partnership with The Portland Trust (TPT). The work has benefited greatly from two previous surveys, sponsored by TPT. The first was done by the Equity Legal Group in 2008 titled "Housing Mortgages in Palestine". The second was carried out by the Near East Consulting in 2009 titled "Palestinian Housing: Survey Results and Affordability Analysis".

Numan Kanafani
Director General

Executive Summary

The aim of this study is to consider the Palestinian housing sector and to address the factors hindering its expansion. The study analyses the factors which affect the demand and supply of houses and the demand for mortgages, a key indicator of efficiency in the housing sector. The study reviews the sources of, and conditions for, mortgage lending in the Palestinian Territory and addresses the specific difficulties facing this type of lending.

The study reviews existing literature on the subject and presents data related to housing and housing investment. In order to estimate the potential demand on mortgage lending, the study reviews a survey that has been conducted to identify consumer preferences, their ability to buy houses, and the volume of their demand. The study also reviews the laws and regulations related to housing and mortgages along with the sources of and conditions attached to mortgage lending in the Palestinian Territory.

The study consists of an introduction and six chapters, the last of which provides a number of policy recommendations to improve the housing sector and mortgage lending in The Palestinian Territory. The study also includes two appendices. The first contains the review of laws and regulations. The second lists the conditions that need to be met to qualify for a mortgage in a number of leading commercial banks and lending institutions operating throughout the Palestinian Territory. The following is a summary of the content of each chapter in the study.

Chapter One reviews the existing literature and previous studies which consider the importance of the housing sector in different economies, and its impact on other sectors. The housing sector contributes between 1-7% of Gross Domestic Product (GDP) in various countries and expenditure on housing usually accounts for 15-35% of total family expenditure. Demand and supply for housing are determined by a number of factors, the most important of which are income, prices and government policy and interventions. Financing is also an important issue affecting the housing sector. Performance of financial institutions, the type and strictness of conditions required for getting a mortgage are important determinants for demand on housing in any country.

The literature review notes that many countries have adopted a strategy based on partnership between different players in the housing sector. International experiences demonstrate that neither the free market nor direct state intervention can alone provide a satisfactory solution to the housing problem.

Chapter Two explores the challenges and difficulties facing the Palestinian housing sector. Difficulties arise from external factors related to the policy of the Israeli occupation and internal factors related to the performance of Palestinian public institutions and weaknesses of mortgage lending. These difficulties have led to a chronic gap between demand and supply of houses, currently estimated at 50,000 units per year. Despite these difficulties, the housing sector remains one of the most important and dynamic sectors in the Palestinian economy. It accounts for the largest portion of total investment, between 50% and 60%, and provides 11% of total employment. The share of housing and construction activities in terms of GDP has been about 14% in recent years. In addition to this, the housing sector has intensive backward and forward linkages with other sectors of the economy. The potential demand on housing is determined by demographic, social, economic, and cultural factors. The decision of a Palestinian family to own a house is significantly motivated by a social-cultural heritage which emphasises the importance of owning a house for the social and psychological security of the family. The decision to buy a house is also affected by a widespread belief that this is the best way to accumulate wealth since land prices continue to rise. Demand is also affected by population growth.

Chapter Three explores the factors determining housing supply. The most important of which include: land prices; areas allocated for building; building regulations; the level of rent; and construction costs. Housing supply in the Palestinian Territory faces a number of serious problems due to both internal and external reasons. Restrictions on land use, and the absence of land registration, have led to a low supply of available sites for building. In addition, rent regulations discourage investment in housing. Building costs are also high in the Palestinian Territory relative to comparable neighbouring countries. This is due to higher wage costs, the price of building materials and the cost of licensing and fees for connection to public utilities.

Chapter Four elaborates on the hypothesis that demand for housing is dependent on family income and house price. House purchases can be financed either from own resources or through borrowing. It is for this

reason that mortgage lending is such an important tool and shapes the entire sector and demand for housing. In order to estimate the effective demand for houses and mortgages, a survey has been conducted. It identifies the preferences of the population with regards to conditions of housing mortgages. A sample has been chosen within which 25% work in the public sector, 25% work in the private sector, 36% own their own businesses, and 5% work in NGOs. The survey suggests that 40% of the sample do not receive their salaries through banks while 75% have no loans from the banking sector. Furthermore, approximately 50% think that they will not be able to fulfil the conditions required to get bank loans either because their income is low or unsteady.

It appears that about 25% of the population, who are above the poverty line, want to own a house or apartment. The majority prefer a housing unit of a size between 120-165 square meters. The Palestinian families whose monthly income ranges between NIS 3-5,000 represent approximately 24% of the families sampled. These families are the most likely to benefit from mortgage programs for affordable housing.

Most families prefer to have a fixed rate mortgage if the repayment period is 15 years or more. 43% of families do not wish the down payment to be more than 10% of the price of the apartment or house. Most families also prefer that the monthly mortgage payment should not exceed 30% of the family's monthly income. The result of the survey also reveals a very low awareness amongst Palestinians about mortgages and the facilities, regulations and benefits available.

Based on the information from the above mentioned survey, the study suggests that affordable housing in the Palestinian Territory should have a number of characteristics: an average unit price of \$60,000; for families with a monthly income of between NIS 3,000 – 5,000; with a down payment between 10% and 20% of the price and a monthly payment between 30%-35% of the income; mortgages should have fixed interest rates, ideally at a rate of 6.5% or below with a re-payment period of 25 years.

These assumptions allow the study to formulate two scenarios for mortgages.

First scenario: this scenario assumes that the down payment will be 10%, and the fixed interest rate will be 6.5%. If the family decides to pay 30% of its monthly income for mortgages and the price of the unit is \$60,000, the

monthly payment will be \$365. This means that the family's monthly income should be \$1,216. The share of families who are able to meet these conditions is about 21% of total Palestinian families. This share declines if the price of housing units increases or if the interest rate increases.

If the families who are ready to pay 35% of their monthly income for servicing their mortgage are included then the above mentioned share of families will increase by 5%. The families who would benefit from the program would then become 26% of total Palestinian families.

Second scenario: this scenario assumes that the down payment is 20% with a fixed interest rate of 6.5%. When the down payment increases from 10% to 20%, and the family are prepared to pay 30% of their monthly income, the monthly instalment declines from \$365 to \$324. This means that the proportion of families which can afford to finance the purchase of an apartment through a mortgage increases to 26%.

If the families ready to pay 35% of their income are added, the percentage of families increases by 11%, that is, the families who will benefit from the program rise to 37% of total Palestinian families. These are the optimal conditions to maximise the number of families who will be capable of taking a mortgage.

It is clear therefore that designing a package with a suitable combination of down payments and interest rates can lead to a sizeable volume of demand for mortgages. There is also an important role for reducing construction costs in increasing the demand.

Chapter Five argues that satisfying the expected demand for mortgages in the Palestinian Territory requires effective financial institutions and lending tools. There are three types of institutions that provide mortgages in the Palestinian Territory: banks, the Palestinian Mortgage and Housing Corporation (PMHC) and specialised housing institutions. Loan conditions are very similar across the three, with slight variations connected to the nature of the institution, working mechanisms, and the target group. In general, mortgage conditions in the above mentioned institutions are limited to the following:

- ✧ The apartment must be registered with the land registry authority. The apartment will act as collateral for the bank or the PMHC until the loan is fully repaid.

- ✧ In the case of a mortgage from a bank, or the PMHC, the person who takes the loan needs to have life insurance and to insure the apartment. The debtor is usually the one who bears the costs of insurance.
- ✧ The person who gets the loan should have his/her salary transferred to the bank which will provide the mortgage or to a bank that is acknowledged by the PMHC.
- ✧ Some financial institutions ask, in addition, for one or more guarantors to also have their salaries transferred to the bank that provided the loan or other banks acknowledged by the PMHC.
- ✧ In some cases the person taking out the loan is asked to provide personal, forward-dated cheques instead of guarantors.

Despite the efforts of financial institutions to expand and develop the mortgage market, they have not managed to overcome all the difficulties facing the housing sector. Mortgage lending still falls short of increasing demand. Also, the guarantees and conditions asked for by the financial institutions are costly and complicated. This is particularly true when considering the need to have a registration certificate of the house at a time when land registration in the Palestinian Territory is a difficult and chaotic process. Furthermore, borrowers face difficulties in providing guarantors, particularly as public sector employees are often not accepted. The hard conditions imposed by the financial institutions negatively affect the demand on mortgages.

The fifth chapter also reviews the role of various institutions in the housing sector such as the Ministry of Public Works and Housing, the Land Authority, the Palestinian Monetary Authority (PMA) and the Capital Market Authority (CMA). These last two institutions have made significant efforts in trying to improve the performance of financial institutions and the mortgage sector. The Ministry has exercised a great deal of effort since the establishment of the Palestinian Authority (PA) in 1994. Millions of US dollars have been assigned from the PA budget, and from international aid, to develop infrastructure and carry out development projects. However, with the absence of a clear and systemised strategy for the housing sector, these efforts were unable to significantly improve the performance of the sector, or to effectively bridge the housing gap. The Land Authority is specialised in land settlement and registration yet it faces many challenges which prevent it from increasing land registration in the Palestinian Territory. This impacts negatively on the volume of land available for construction purposes and keeps land prices high.

The concluding chapter of the study provides a number of recommendations to develop the housing sector and improve mortgage conditions in the Palestinian Territory. The recommendations include:

- ✧ Creating an adequate legal environment is of vital importance. It is essential for the success of efforts to develop the housing sector. Legislation required includes: a new land law, mortgage law, immovable property law, a new law for registering apartments, and renting law. The banking law also needs amending to include articles that encourage banks to increase the volume of mortgage lending.
- ✧ The working mechanism of the Land Authority needs developing. Efforts should be made to improve efficiency and strengthen its ability to fulfil its mandate.
- ✧ Measures to decrease construction costs and increase the number of available housing units should be designed and followed. Such measures might include assigning governmental land for housing projects, striving to expand registered land, supporting the local construction industry with incentives and tax exemptions, decreasing dependency on imported raw materials, and conducting research into alternative and low cost building materials (such as artificial stone and prefabricated walls). In addition, it is essential to review and adjust the requirements set by municipalities and the high licensing fees for housing projects.
- ✧ Housing cooperatives should be encouraged and receive greater support. For example, governmental land, or larger amounts of international aid, could be passed to them.
- ✧ The importance of an awareness campaign about mortgages cannot be understated. This is particularly important since resources are scarce and Palestinians generally have limited savings. The campaign should explain how mortgages work and how they make buying a house possible for many more families.
- ✧ The Palestinian Authority, and the PMA, should provide financing institutions with greater reassurances and incentives in order to encourage increased lending. Simultaneously, efforts could be made to develop an environment that helps families with loans meet the terms and conditions of the mortgage.
- ✧ Finally, high-quality infrastructure plays a crucial role in decreasing building costs and expanding new and existing housing projects. It is therefore essential that programs to develop Palestinian infrastructure are prepared and implemented.